



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Legislative Fiscal Analyst
CLAYTON SCHENCK

DATE: November 20, 2007

TO: Members of the Legislative Finance Committee
Members of the Environmental Quality Council

FROM: Barbara Smith, Fiscal Analyst II

RE: Solvency of the Petroleum Tank Compensation Fund

At the request of Senator Wanzenried, I am forwarding a copy of the response to his recent legislative request regarding the solvency of the Petroleum Tank Compensation Fund. The purpose of this is to provide both committees with information for future discussions. The Legislative Finance Committee will hear an update on this issue at the December 12th meeting. The Environmental Quality Council will also discuss this information in January.

If you have any additional questions, I can be reached at 444-5347 or via email at basmith@mt.gov.

C Clayton Schenck
Todd Everts
Taryn Purdy
Tom Livers, Deputy Director, Department of Environmental Quality
Greg Cross, Chair, Petroleum Tank Compensation Board
Terry Wadsworth, Executive Director, Petroleum Tank Compensation Board



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Legislative Fiscal Analyst
CLAYTON SCHENCK

October 18, 2007

Senator David Wanzenried
903 Sky Drive
Missoula, MT 59804-3121

Dear Senator Wanzenried:

The following is in response to your request regarding the petroleum tank compensation fund. The petroleum tank compensation fund (herein after referred to as the "fund") was established in 1989 to provide a funding mechanism to address timely cleanup of tank releases. The fund is statutorily appropriated to provide for claims reimbursement, but administrative appropriations for fund management and tank regulation is appropriated by the legislature. Since the inception of the fund, \$77.5 million has been paid out for eligible releases. Recently, fund status information was provided to the Environmental Quality Council which indicated potential solvency issues. The purpose of this report is to address the use of the fund and the potential long-term solvency of the fund.

FUND OPERATIONS - BACKGROUND

The purpose, process and requirements of the fund are addressed in Chapter 75, Title 11, part 3. The legislative intent of the fund is documented in 75-11-301, MCA, and includes the following purpose:

- (6) The purposes of this part are to:
- (a) protect public health and safety and the environment by providing prompt detection and cleanup of petroleum tank releases;
 - (b) provide adequate financial resources and effective procedures through which tank owners and operators may undertake and be reimbursed for corrective action and payment to third parties for damages caused by releases from petroleum storage tanks;
 - (c) assist certain tank owners and operators in meeting financial assurance requirements under state and federal law governing releases from petroleum storage tanks; and
 - (d) provide tank owners with incentives to improve petroleum storage tank facilities in order to minimize the likelihood of accidental releases.

The Petroleum Tank Compensation Board ("board") provides the oversight and direction of the program. Tank owners and operators can apply for funding to assist with the corrective action

costs to address a release and other damages caused by the release. The board operates under guidance provided by statute (75-11-318, MCA) board adopted rules, and staff advice.

The Remediation Division of the Department of Environmental Quality (DEQ) is responsible for oversight of the facility owner or operator in assessing the potential threat to human health and the environment, and provides assistance with corrective action plans when a release has occurred. If a corrective action plan is completed, it is forward to the board for eligibility determination.

When the board has made a determination of eligibility, claims reimbursement is evaluated considering any deductibles required by law, compliance issues, and availability of other resources.

HISTORICAL REVENUES AND EXPENDITURES

In response to concerns over the viability of the fund, the legislature modified statute to require the board to conduct an analysis of the short and long-term viability of the fund to the department director and the Legislative Auditor. A copy of this report is attached and is referenced in this document.

For this report, structural balance is being addressed through the comparison of revenues and expenditures.

Revenues

The fund receives the majority of revenues from a 0.75 cent fee per gallon of gasoline, heating oil, special fuel, aviation fuel and ethanol distributed within the state or exported or sold for export out of state. Additional revenue can be obtained through cost recovery from a liable party, fund interest or loan proceeds. Figure 1 below summarizes revenues from FY 2000 to FY 2007.

Figure 1 Historical Revenues									
Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007	Total
Per Gallon Fee	\$6,248,375	\$6,169,082	\$6,159,720	\$6,268,941	\$6,519,369	\$6,654,339	\$6,821,051	\$6,826,132	\$51,667,009
Cost Recovery	0	0	0	0	28,927	6,255	945,998	113,379	1,094,559
Interest Earnings	179,970	150,839	18,491	18,655	17,054	35,728	79,188	55,082	555,007
Loans	0	0	0	1,000,000	0	0	0	0	1,000,000
Other Non budgeted Income	<u>0</u>	<u>0</u>	<u>90,400</u>	<u>46,227</u>	<u>1,321</u>	<u>627</u>	<u>1,398</u>	<u>0</u>	<u>139,973</u>
Total	<u>\$6,428,345</u>	<u>\$6,319,921</u>	<u>\$6,268,611</u>	<u>\$7,333,823</u>	<u>\$6,566,671</u>	<u>\$6,696,949</u>	<u>\$7,847,635</u>	<u>\$6,994,593</u>	<u>\$54,456,548</u>

The revenues from the per gallon fee have grown 9.2 percent over the past eight years, or an average of 1.3 percent per year. The growth can be attributed to an increase in the number of gallons of diesel fuel that have been distributed in the past four years. Revenue from gasoline and aviation fuel has not fluctuated widely over the past eight years. Total revenues from FY 2000 to FY 2007 from this fee have been \$51.7 million, an average of \$6.46 million per year.

Interest income and cost recovery revenues have varied considerably. Interest income can be correlated with the fund balance and performance of the short term investment pool. Cost

recovery is based solely on when third party litigation is settled and when the board receives payment from the insurer.

From all sources the fund has collected \$54.5 million in revenues, equating to an average of \$6.8 million per year.

Expenditures

Appropriations from the fund for administrative and regulatory functions are made through the legislative appropriations process and are contained in HB 2. The board has statutory authority for claims reimbursement and debt service for any advance or loan made to the fund. Figure 2 provides a summary of historical expenditures.

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007	Total	Average
Legislative Appropriation										
Personal Services	\$782,844	\$851,787	\$918,451	\$1,008,330	\$949,486	\$997,696	\$1,096,131	\$1,087,569	\$7,692,294	\$961,537
Operating	<u>523,731</u>	<u>527,515</u>	<u>577,505</u>	<u>588,257</u>	<u>559,421</u>	<u>610,959</u>	<u>939,032</u>	<u>674,132</u>	<u>5,000,552</u>	<u>625,069</u>
Sub total	1,306,575	1,379,302	1,495,956	1,596,587	1,508,907	1,608,655	2,035,163	1,761,701	12,692,846	1,586,606
Statutory Appropriation										
Claims	5,334,095	5,799,130	5,985,691	3,731,611	4,844,535	4,911,911	5,294,311	7,554,982	43,456,266	5,432,033
Debt Service	<u>148,989</u>	<u>161,597</u>	<u>153,662</u>	<u>201,037</u>	<u>56,958</u>	<u>37,550</u>	<u>40,925</u>	<u>36,132</u>	<u>836,850</u>	<u>104,606</u>
Sub total	5,483,084	5,960,727	6,139,353	3,932,648	4,901,493	4,949,461	5,335,236	7,591,114	44,293,116	5,536,640
Total	<u>\$6,789,659</u>	<u>\$7,340,029</u>	<u>\$7,635,309</u>	<u>\$5,529,235</u>	<u>\$6,410,400</u>	<u>\$6,558,116</u>	<u>\$7,370,399</u>	<u>\$9,352,815</u>	<u>\$56,985,962</u>	<u>\$7,123,245</u>

The costs of the administrative and regulatory functions have risen slightly over the last two years. This can be attributed to increased legal costs of the board and increased indirect charges to cover services provided by the legal or fiscal unit of the Central Services Division within DEQ. Personnel costs have fluctuated with legislature approved pay raises and increased costs of health care. The average cost of the administrative functions of the board and oversight by the Remediation Division is approximately \$1.6 million per year.

Claims reimbursement and debt service are a different story. Claims average out at \$5.4 million per year. However, a sharp increase in claims occurs in FY 2007. This is the result of the increase in the number of work plans requested and approved over the past year. In doing this, the board essentially must wait for FY 2008 revenues to materialize to make progress on the claim back log. The other option is for the board to borrow from the board of investments, as allowed under 17-6-225, MCA (attached).

Structural Balance

A simple measurement of solvency is to determine if revenues exceed expenses. In the case of this fund, structural balance was achieved four of the last eight years. As per the Figure 3 below, FY 2007 represents the worst year for structural balance since FY 2000. Again, this increase is a result of the increase in the number of work plans requested and approved by the board over the past year.

Figure 3
Structural Balance

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007	Total
Revenues	\$6,428,345	\$6,319,922	\$6,268,611	\$7,333,823	\$6,566,672	\$6,696,950	\$7,847,636	\$6,994,593	\$54,456,552
Disbursements	6,789,659	7,340,029	7,635,309	5,529,235	6,410,400	6,558,116	7,370,399	9,352,815	56,985,962
Difference	(\$361,314)	(\$1,020,107)	(\$1,366,698)	\$1,804,588	\$156,272	\$138,834	\$477,237	(\$2,358,222)	(\$2,529,410)

SHORT – TERM FUND SOLVENCY

Whether the situation continues, is dependent upon the management of the fund. The board has taken some action to address the shortfall. The board implemented action in February 2007 requiring a fund balance of \$1.0 million and to reimburse claims on a first-complete basis. In addition, as of May of 2007 the board limited the monthly review of corrective action plans to the amount of monthly fund income. Both of these actions slow the pace of obligating the fund, but do not reduce the long-term burden of the fund.

LONG-TERM FUND SOLVENCY

Long-term viability will be impacted by the number of releases and discovery of historic tanks as well as managerial decisions made by the board and implemented by board staff.

The board released a biennial fund status report in June of 2006 stating that liabilities are slowing due to less costly cleanup, fewer releases, fewer “found” tanks requiring cleanup, more localized cleanup and improved technology. However, actual activity in FY 2007 did not show a decline, but rather a large increase in claims. If annual activities continue to increase, rather than level out, the fund will not remain solvent in the long run.

Fund solvency is also affected by management decisions. The potential for the fund to remain viable in the long run is related to the manner in which the board manages this fund and the remediation program manages cleanup. For example, the board recently (July 2007) began to obligate funding based on a priority system whereas the more serious (and costly) releases were provided higher priority than a low priority site. An owner/operator of the low priority site would receive financial assistance for cleanup only when higher priority site claims have been resolved. This places those sites at greatest risk of harming the environment in the front of the line for payment.

Other managerial issues that would affect the solvency of the fund include:

- Default payer of claims – The fund is used as the default payer of claims, rather than the payer of last resort. The fund expends revenues for releases where an insurance policy exists and those funds are not recovered in full as third party legal services are paid from the actual recovery from the insurance company.
- Implementation of priority claims system - The priority claim system is new. It is not yet possible to determine if implementation of this system has slowed the rate of remediation for tank releases.
- Amount of minimum claim – Board policy sets a minimum claim amount of \$200, which can be over-ridden for good cause by board staff. This policy was implemented in 1998 to reduce small claims activity that exceeds the cost of doing business. The policy has not been updated to reflect the increased costs to the board to process claims.

- Delegated authority to board staff – The board has given permission to the staff to process claims that are under \$25,000. According to the last set of minutes of the board, the staff processed \$0.8 million in claims and \$0.16 million was held for board review.

REGULATORY FACTORS OF IMPORTANCE –

Administrative rule 17.56.805 establishes the amount and scope of financial responsibility owner/operators need to have available to provide for financial cleanup of accidental releases or releases resulting from operation. The rule states:

“(1) Owners or operators of petroleum underground storage tanks must demonstrate financial responsibility for taking corrective action and for compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks in at least the following per-occurrence amounts:

(a) for owners or operators of petroleum underground storage tanks that are located at petroleum marketing facilities, or that handle an average of more than 10,000 gallons of petroleum per month based on annual throughput for the previous calendar year; \$1 million.

(b) for all other owners or operators of petroleum underground storage tanks; \$500,000.

(2) Owners or operators of petroleum underground storage tanks must demonstrate financial responsibility for taking corrective financial responsibility for taking corrective action and for compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks in at least the following annual aggregate amounts:

(a) for owners or operators of 1 to 100 petroleum underground storage tanks, \$1 million; and

(b) for owners or operators of 101 or more petroleum underground storage tanks, \$2 million.”

Subsequent rules address how the financial responsibility can be met, such as self-insurance, private insurance, trust fund, surety bond as well as the fund. The rules allow the owner/operator to use a combination of these to meet the financial requirements. This allows the owner/operator can use the fund as a means to prove they have adequate financial resources for cleanup.

However, the rules do not provide for a review of these financial documents at any specific interval, but does require DEQ to be notified by the owner/operator if the financial assurance changes.

Montana is not in a unique situation. In a February 2007 report by the Governmental Accountability Office (GAO), Montana is listed as one of fifteen states that reported reviewing financial assurance information at intervals of 3 years or greater. A summary of this report is attached for reference. This type of management creates pressure on the fund, as without regular monitoring showing that tank owners/operators are maintaining financial assurance for releases, the coverage may lapse and can result in an increase in utilization of the fund.

LEGISLATIVE ACTIVITIES

Few adjustments to the operations of the board have recently been made by the legislature. During the 2005 session, SB 145 was passed and approved to direct the board to compile and report information on the availability of petroleum tank liability insurance in the private market.

This information was to be included in the biennial report on fund status. The board did include the results of an email based survey in their June 2006 status report. Insurance coverage for new leaks is becoming more affordable; however coverage for preexisting contamination is expensive.

In preparing for the 2007 legislative session, the board held discussions regarding potential legislation, including the process to follow as an administratively attached board to DEQ. These discussions focused around the concerns of the department regarding bringing forward legislation to provide for a fee increase and the possibility of executive approval of such an increase. The board, after a number of discussions decided to pursue legislation without going through the department.

In December of 2006, the board agreed to potential legislation to temporarily increase the 0.75 cent per gallon fee to a 1 cent per gallon fee to address the impending backlog of claims, reduce administrative costs and pursue a trust fund for historical spills. That bill was requested by Representative Harry Klock. During the February 2007 board meeting, the following motion was made regarding the proposed legislation:

“Mr. Noble moved that the Board is satisfied with the language in the proposed legislation in LC2310 and will request that Representative Klock carry forward the bill as currently drafted, upon the Governor’s approval. Ms. Blazicevich seconded. **The motion was unanimously approved. “**

The bill draft was placed on hold on March 26, 2007 and was never introduced.

The board is currently back in discussions regarding the need for legislation to address fund solvency through a 0.25 cent per gallon increase. The minutes of the July 2007 board meeting indicated that DEQ, the board and the marketers association are working together to formulate legislation. There does not appear to be any evidence that any legislator or interim committee has been involved in this process.

SUMMARY

The petroleum tank compensation fund revenues are flat, administrative expenses are stable, however claims fluctuate based on the number of work plans submitted to and approved by the board. The board has made recently policy changes to slow the obligation of funds which will aid in short-term solvency. Long-term solvency is at risk unless managerial or statutory changes are made to balance revenues and expenses.

OPTIONS

The legislature may wish to consider addressing all the issues through a workgroup or subcommittee of the Legislative Finance Committee and the Environmental Quality Council. This may include:

- Finance assurance of owner operators through private insurance or other means to decrease pressure on the fund
- Analyzing the need for a short-term or permanent increase to the per gallon fee

- Institutionalizing a priority claims payment system
- Increase the minimum claim amount processed by the board
- Review the utilization of co-payments and deductibles to assure owner/operator participation in cleanup costs
- Reviewing subrogation policies for claims already in process to change the position of the fund to payer of last resort, rather than the default payer.

If you should need further information, please feel free to contact me at 444-2986 or email at me basmith@mt.gov.

Sincerely,

Barbara Smith, Legislative Fiscal Analyst
Legislative Fiscal Division